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Foreign Economic Trends and Their Implications for the United States

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TURKEY

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KEY ECONOMIC INDICATORS

In millions of U.S. dollars unless noted

	1987	1988	1989
Domestic Economy			
Population (millions)	52.8	54.2	55.6
Population growth (%)	2.5	2.5	2.5
GDP in current dollars (a)	61855.6	65515.2	71800.3
GNP in current dollars (a)	61961.8	64343.9	73150.0
Per capita GDP, current dollars	1171.3	1190.3	1291.0
GDP in Turkish lira (a)			
% change in 1968 prices	6.5	4.7	0.4
GNP in Turkish lira (b)			
% change in 1968 prices	7.4	3.7	1.7
Consumer Price Index % change	55.1	75.2	68.8
Production and Employment			
Labor force (1,000s)	(c)	18350	18860
Unemployment (average % per year)	(c)	9.8	10.4
Industrial production (1986=100)	110.5	112.3	161.4
Government deficit as % of GDP (d)	4.4	3.8	4.2
Balance of Payments			
Exports (F.O.B.) (e)	10190	11662	11628
Imports (C.I.F.) (f)	14158	14335	15763
Trade balance (g)	-3229	-1777	-4201
Workers' remittances	2102	1865	3138
Current Account balance	-982	1596	966
Foreign direct investment (new)	106	354	663
Foreign debt (year-end) (i)	38304	40228	40772
Debt service paid	5951	8435	6797
Debt Service			
(% of merchandise exports) (h)	57.6	71.2	65.5
Foreign exchange reserves (year-end)	3959	5229	7330
Average exchange rate (TL/$)	856	1422	2121
Foreign Investment			
Cumulative Total (million TL)	435568	784715	1949555
Cumulative U.S. (million TL)	44162	67312	124406
U.S. share (%)	10.1	8.6	6.4
U.S.-Turkey Trade			
U.S. exports to Turkey (C.I.F.)	1365.4	1519.7	2094.3
U.S. imports from Turkey (F.O.B.)	713.2	760.7	971.0
U.S. share of Turkey's exports (%)	7.0	6.5	8.4
U.S. share of Turkey's imports (%)	9.6	10.6	13.3
U.S. bilateral aid			
Economic	100	32	60
Military	493.5	493.3	503.4

Principal U.S. exports (1989): Machinery and transportation equipment, ferrous waste and scrap, chemicals, wheat, rice, corn and coal.

Principal U.S. imports (1989): Petroleum, tobacco, textile fibers and products, steel, food items.

NOTES:

(a) at factor cost
(b) at purchaser's value
(c) a new method of calculation covers 1988 and 1989 only
(d) consolidated central budget deficit
(e) excludes transit trade
(f) excludes imports of nonmonetary gold and transit trade
(g) includes transit trade, insurance and gold imports
(h) F.O.B. value of merchandise exports excluding transit trade
(i) new method of debt calculation conforms to International Monetary Fund (IMF) standards. 1989 debt figure includes that portion of Foreign Military Sales (FMS) debt refinanced through commercial banks

Sources: State Institute of Statistics, Central Bank of Turkey, State Planning Organization

SUMMARY*

The Turkish economy took off with a bang during the mid-1980s, as an export-led growth strategy and free market principles propelled it into the ranks of the fastest growing economies in the Organization for Economic Cooperation and Development (OECD). At the end of the decade, Turkey experienced a slowdown in economic growth, but its external situation gained strength. In 1989, for the second year in a row, Turkey's current account showed a positive balance. The $966 million surplus resulted primarily from increases in workers' remittances and tourism receipts, as the merchandise trade deficit grew. Liberalizations in Turkey's trade regime and the move toward free convertibility of the Turkish lira have encouraged the international financial community. Foreign exchange reserves of $7.3 billion at yearend 1989 and timely debt service payments on a stable $41 billion total foreign debt are reasons for continued optimism.

There are positive signs in 1990 for domestic economic recovery and growth as well. The Turkish economy's gross national product (GNP) grew just 1.7 percent in real terms in 1989. A serious drought, inflation in the 60-70 percent range, and political uncertainty contributed to the disappointing showing. But an upswing in industrial production during the second half of 1989 has continued into 1990, and rainfall has approached normal levels. Because of the continued recovery, Turkey's economic planners may be successful in their prediction of a 5.7 percent growth rate in 1990. It will be more difficult to bring down inflation, which continues to be one of the most serious problems facing President Ozal and Prime Minister Akbulut. If the Wholesale Price Index (WPI) average increase for 1990 is reduced to 54 percent, the rate on which the 1990 Economic Program is based, economic officials realistically will view this as a significant achievement.

CURRENT ECONOMIC SITUATION AND TRENDS

Economic Growth: The disappointing 1.7 percent GNP growth rate (in producers' value, 1.21 percent at factor cost) was due primarily to serious drought conditions in 1989, which affected the agricultural sector as well as agro-based subsectors of the manufacturing, trade, and transportation industries. The agricultural sector, which represented 19.1 percent of GNP (factor cost in constant prices), declined by 11.1 percent. Looking at value-added in the agricultural sector, the biggest drops were in cereals (23 percent) and pulses (29 percent). Near-normal rainfall in the spring of 1990 suggests that the agricultural sector will rebound from the disaster of 1989.

The industrial sector, which represented approximately 26 percent of GNP, recovered during the second half of 1989 ending the year with 3 percent growth. The average increase in 1989 manufacturing production was 2.1 percent. The private sector led the recovery as the public sector continued to show production losses.

* This report was prepared in June 1990.

While private sector manufacturing production increased 6.6 percent, public sector production declined 5.5 percent. Largest gains were made in the primary metal industry (22.8 percent) and the machine industry (34.5 percent). During the fourth quarter, capacity utilization in the manufacturing sector had risen to 79.6 percent (from a low of 63.1 percent during the second quarter). Production during the first quarter of 1990 continued to show impressive gains with an 11.3 percent increase over production in the first quarter of 1989.

Consumption and Investment: Final 1989 statistics are not available, but consumption is estimated to have increased 2.8 percent in 1989. Generous "catch up" wage increases in the public sector during mid-1989 contributed to the increase in effective demand.

According to preliminary estimates for 1989, fixed investment declined 3.4 percent in real terms. Private sector investment increased only 2.7 percent, following increases in the 13-19 percent range between 1986 and 1988. Public investments dropped 10.2 percent, for the third year in a row. Turkey's Central Bank estimates that investment is picking up steam in 1990, and the State Planning Organization's (SPO) 1990 Economic Development Program projects a 7.2 percent increase in total fixed capital investments.

Inflation, Wages, and Monetary policy: Turkey's bout with inflation continued in 1989. The economic planners have found that the factor least resistant to change in the inflation equation is that of inflationary expectations. The average annual rate of inflation in 1989 was close to 70 percent. At yearend, the Wholesale Price index (WPI) showed a 68 percent increase. There was a bit of controversy in early 1990, as the State Institute of Statistics released its new Wholesale and Consumer Price Indices (CPI) with a base year of 1987. While these new indices did indicate a deceleration of inflation, the extent of the decline was not sufficient to arouse sustained public suspicion. As of the end of May 1990, the WPI showed an annual increase of 58.4 percent, the lowest annual rate since 1988.

Persistent inflationary expectations will not change unless the public sees a reason to believe prices will go down. The public sector deficit remains a serious problem and the major contributor to the inflationary spiral. In addition to the drought, very large increases in public sector salaries contributed to high rates of inflation in 1989. Hefty (over 100 percent) increases in government workers' wages in mid-1989, while necessary and overdue (real wages in the public sector had declined steadily), put a shot into the economy's arm that may have helped it out of the recession, but it exacerbated the public sector's spending problems as well as inflation.

Turkey's inflation problem traditionally has stemmed from overzealous fiscal policies which lead to expansion of the money supply. Turkey's Central Bank continues to seek more autonomy and since 1988 has followed a tight monetary policy. In January 1990, the Central Bank instituted a comprehensive monetary policy that targets items in the Central Bank balance sheet rather than macroeconomic variables in order to lower the Central Bank's foreign exchange risk and allow reasonable growth in the bank's assets and liabilities. As of the first five months of 1990, the Central Bank was within its targets, but the success of its policy is dependent on a complementary fiscal policy.

Public Finance: The real problem with the Turkish budget is revenues not expenditures. Economic officials claim that expenditures cannot be reduced further. Instead, the tax system must be made to work. Improving enforcement of the tax system and strengthening sanctions against violators is a political decision that the Turkish Government has not yet made.

The consolidated central budget (including general and annex budget organizations, but excluding state economic enterprises and extra-budgetary funds) ran a deficit of an estimated 7 trillion Turkish lira in 1989. Budget financing amounted to approximately 4.5 percent of GNP versus 3.9 percent in 1988. The budget deficit for 1990 is estimated to reach 10.5 trillion Turkish lira or 3.8 percent of targeted GNP. As of the first quarter of 1990, the budget deficit was 205 percent higher than in the same quarter of 1989, indicating that this estimate may be too optimistic.

Under the leadership of President Turgut Ozal, who was Prime Minister from 1983-1989, the Turkish Government embarked on an ambitious program to privatize the SEEs, which contribute significantly to the public sector's deficit as well as to inflation through inefficient operation and nonmarket pricing of their products. The program hit some snags in 1990, and its future, specifically the role of foreign investors in privatization, is uncertain. In early 1990, the Turkish Government stepped up its public offerings of government-held securities (of private as well as state-controlled enterprises) and transferred revenues from the sales to the budget.

Balance of Payments: Turkey's current account registered a $966 million surplus despite a trade deficit of $4.2 billion. Exports were stagnant at $11.66 billion, but tourism receipts grew 8.6 percent to $2.56 billion, and workers' remittances jumped 71.8 percent to $3.17 billion. Imports grew 10 percent to $15.76 billion, in part due to mid-1989 reductions in tariffs and import surcharges. These reductions were aimed at stimulating domestic production and reducing domestic prices by providing greater competition. Gold imports also contributed to the trade deficit, soaring from $32 million in 1988 to $1.06 billion in 1989 with the creation of a gold exchange.

Exporters blame the 0.3 percent drop in 1989 exports on the elimination of export tax rebates and on the appreciating lira. The rebate, which had been a subsidy for exporters, led to the practice of reporting fictitious exports. Its elimination ended that practice and the distortions it caused in trade statistics. Regarding exchange rates, the Turkish lira appreciated 27 percent in real terms against the U.S. dollar in 1989. The Central Bank stresses that market forces, not the Turkish Government, now determine the exchange rate.

Another factor in the stagnation of exports was the drought, which caused agricultural and livestock exports, which equaled 20 percent of Turkey's 1989 exports, to drop 9.2 percent in 1989. Also, Turkey's exports to Iraq, which totaled $986 million in 1988, dropped to $446 million in 1989. The Turkish Government stopped guaranteeing letters of credit due to arrearages in Iraq's export payments.

The United States was Turkey's third largest market for exports in 1989. Receiving $970.4 million, or 8.3 percent of Turkey's exports, the United States ranked behind West Germany (18.7 percent) and only slightly behind Italy (8.3 percent). Turkey's major exports in 1989 were textile products (32.6 percent of the total), and ores, iron, and steel products (15 percent). West Germany was the largest foreign supplier of goods to Turkey in 1989, with a 14 percent share of the Turkish import market. The United States came in second with $2.09 billion, or 13.2 percent, and Iraq was third with 10.5 percent. Primary imports were machinery and equipment (20.4 percent of total imports), ores, iron, and steel products (16.4 percent), and crude oil (15.6 percent).

Gains in exports in 1990 are dependent on continued increases in production, normal agricultural output, and the relative value of the Turkish lira. Chances are good that exports will improve, but growth in imports is likely to continue to outpace export gains. Another current account surplus is possible, but the target of $874 million may be overly optimistic.

FOREIGN EXCHANGE POLICY AND FOREIGN INVESTMENT: Following a Turkish Government decree in August 1989 and amendments thereto

in March 1990, the Turkish lira became fully convertible. The move to full convertibility should further facilitate foreign investment in Turkey as well as investments abroad by Turkish citizens. The inflow of foreign direct investment in Turkey equaled $663 million in 1989, up from $354 million in 1988. The amount of capital authorized for entry was much higher, however, growing 78 percent to $1.47 billion.

In 1989, the United States ranked fourth in amount of new investments authorized, with $340.4 million. The U.S. share of cumulative foreign investments was 6.4 percent at year-end, and approximately 130 U.S. firms have invested capital in Turkey. But these figures understate the real involvement of U.S. investors in Turkey, because they do not capture investments made by foreign subsidiaries of U.S. firms. A bilateral investment treaty implemented by Turkey and the United States in May 1990 should facilitate mutual investments. The treaty guarantees that Turkish investors in the United States and American investors in Turkey will receive national treatment. It provides for access to all the laws and regulations which affect investments, the unrestricted right to repatriate capital, profits, and dividends, and international arbitration of disputes.

Turkey succeeded in attracting the Japanese auto giant Toyota to invest $325 million in a plant which will produce autos for the domestic market and for export. Liberalizations in the foreign trade and exchange regimes and Turkey's sincere efforts to attract foreign investment are likely to increase the inflow of capital in years to come. While Turkey needs to resolve domestic economic problems such as inflation, the climate for foreign investors is generally very good. U.S. officials are discussing with Turkish authorities the need to improve protection of intellectual property in Turkey. More progressive laws to protect copyrights and patents will make the climate even more attractive to foreign investors.

IMPLICATIONS FOR THE UNITED STATES

Business prospects for U.S. firms selling to or investing in Turkey remain very promising. The Turkish Government's enlightened and liberal policy of actively seeking foreign investment and increasing foreign trade levels bodes well for the Turkish economy, and, inter alia, U.S. business interests. U.S. exports to Turkey rose more than $500 million in 1989, or almost 38 percent, relative to an increase in total Turkish imports of less than $1.5 billion, or less than 10 percent. U.S. trade data indicate that U.S. exports to Turkey are dominated by agricultural commodities and industrial raw materials. But it is clear from market research that U.S. manufactured products such as computers, medical equipment, telecommunications equipment, power generation equipment, scientific and analytical equipment, food processing and packaging equipment, and construction equipment are very competitive in the Turkish

market. These products, however, are credited on the export tallies of European countries from which they are ultimately shipped to Turkey by subsidiaries of U.S. firms. Statistics also do not fairly represent the extent of U.S. investment in Turkey. Official figures indicated that the United States lost ground relative to third countries in new investment in Turkey during 1989, although net new U.S. investment rose by almost 85 percent. Much of European investment is actually through European subsidiaries of U.S. firms.

There is much to recommend Turkey as a place to do business -- the government's enlightened and liberal trade and investment policies; a disciplined and productive work force; vast undeveloped and underdeveloped mineral and agricultural resources; enormous potential for development of the tourism sector; strategic geographic location between the European (Western, and now Eastern) and Middle Eastern markets, and the government's deliberate intent to shrink the public sector share of the economy while stimulating and encouraging domestic and foreign private investment. Most importantly, however, the high probability that Turkey's liberal, market-oriented macroeconomic policies will endure regardless of what government comes to power is at the root of investor confidence and exporters' enthusiasm.

U.S. investors continue to be prominent in the services sector, including banking, advertising, public accounting, and consultancy. Nine of the largest U.S. banks are represented in Turkey through branches, representative offices, or in joint-venture banks. Likewise, a majority of the U.S. "big eight" public accounting firms are already established in Turkey, and other U.S. firms have recently opened offices to provide legal and advertising services. A new law scheduled to go into effect June 30, 1990 would make it much more difficult for foreign public accounting firms based in Turkey to do business effectively. U.S. officials are working together with U.S. firms and Turkish authorities, and it appears that problems associated with the law will be resolved.

Significant new U.S. manufacturing investment (General Motors, E.I. DuPont, FMC, Gillette Corporation, Coca Cola, Rockwell International, and Tenneco) as well as many important firms in the services sector (banks, courier services, engineering design and consultancy firms, insurance, and oil exploration companies), and large numbers of marketing subsidiaries of U.S. firms (Digital Equipment Corporation, Hewlett Packard, Carrier Corporation, Martin Marietta, Kodak, Warner Brothers, TWA, Xerox, and last but not least, Pizza Hut and Wendy's) established presences in Turkey during 1989.

Opportunities in the agribusiness, tourism, and defense sectors have so far attracted the most direct U.S. investment, but the Turkish Government's plans to privatize many state-owned enterprises will also attract additional foreign investment.

Block sales to foreign concerns of state enterprises may be on hold for the time being, but substantial privatization, which will require some foreign investment, is likely over the longer term. Petrochemical, textile and apparel manufacturing operations, touristic facilities, and even Turkey's national airline are slated to be offered to private buyers in the near future.

There are expanding opportunities for trade with and investment in Turkey. However, public investment is at present constrained, as the government attempts to control the public sector deficit in order to reduce inflation. Many major government tenders still require suppliers' credits. Suppliers should consider unconventional project financing packages (e.g., the utilization of third-country export credits) when bidding on major government infrastructure projects. In the private sector, new investment in plant and equipment to supply the domestic market is rising steadily. Turkish manufacturers with exportable products remain the best targets for sales.

The Turkish Government's private sector orientation is evident from the techniques it has used in negotiating with foreign firms interested in building power plants, a new international airport and world trade center complex in Istanbul, and toll roads. The government has invited foreign firms to submit proposals on the "build, operate, and transfer" (BOT) model, in effect transferring much of the financial and operating risk to project sponsors. The Turkish Government plans to implement several major energy and infrastructure projects, and the State Planning Organization (SPO) has published a listing of major projects with a total investment value in the billions of dollars for which it is seeking foreign financing.

U.S. exporters, including engineering and technical consulting services firms, should note that Turkey is a major beneficiary of the NATO (North Atlantic Treaty Organization) infrastructure development program. Spending on NATO projects, which run the gamut from harbor development projects to satellite communications networks, is expected to continue at the recent level of about $5 billion annually, NATO alliance-wide. U.S. firms wishing to compete for these projects usually must possess a NATO security clearance and must be certified by the Office of Major Projects of the U.S. Department of Commerce as financially and technically qualified. Information about NATO infrastructure projects is reported to the U.S. Department of Commerce in Washington, D.C., by U.S. Embassies in NATO member countries, and is published in Commerce Business Daily, it also is available through the "Trade Opportunities Program."

Export Sales Opportunities: The Turkish private sector has a steadily increasing demand for computers, related software, and services. U.S. exporters of EDP equipment offering local service and training can expect to enjoy an excellent export market in

Turkey for years to come, especially in the banking sector and in government agencies. New emphasis on improving the health care and educational sectors is also expected to lead to an expanded market for medical diagnostic equipment and educational equipment and consulting services in the near term.

Surveys on the Turkish markets for mining and construction equipment, telecommunications equipment, power generation equipment, food processing equipment, computers, analytical instrumentation, coal, and fertilizers, as well as other products and services related to agriculture, steel, and medical equipment can be obtained at Department of Commerce district offices, the American Embassy in Ankara, or the American Consulate General in Istanbul.

To promote U.S. exports to Turkey, particularly to introduce products which represent new technology, the U.S. Government supports an American Pavilion at the Izmir International Trade Fair, held annually during August 26-September 10. Inquiries regarding participation may be directed to the Foreign Commercial Service, American Embassy, Ankara, APO New York 09257-0006.

Import Procedures: The Ozal government's liberalization program is a dramatic departure from previous governments' policies. The Turkish Government is progressively and comprehensively reducing import duties and surcharges. Reduction of import duties and surcharges accelerated during 1989. An important revision of the Turkish import regime during 1990 makes possible the importation into Turkey of used and reconditioned equipment. The Embassy has prepared a comprehensive report on this recent change, which creates significant new opportunities for sales of, inter alia, used and reconditioned computers, medical equipment, metalworking equipment, and telecommunications equipment.

In general, most products may be freely imported without government permission or license. Those few items which still require permission from the Undersecretariat of Treasury and Foreign Trade before importation are arms and ammunition, olive oil, and sunflower seed oil. Certification that quality standards have been met is required from the Ministries of Health and Agriculture for the importation of human and veterinary drugs and certain foodstuffs. Import certificates are required from the Ministry of Industry for most products which require after-sales service (e.g., photocopiers, EDP equipment, and diesel generators). The import regime consists of a core list which indicates the necessary customs duties and surcharges for each commodity. A second list consists of commodities which are encouraged for investment purposes and are exempt from customs duties (surcharges are still levied). In the past, importers had to make a security deposit when opening a letter of credit. This practice has been abolished.

Investment and Licensing Opportunities: In recent years, due to high interest rates and low domestic consumption, the private sector has been reluctant to undertake major new capital investments and has tended instead toward the modernization/ expansion of existing plants and equipment. Major new investments have, during the last several years, predominantly been joint ventures with foreign firms. The best opportunities for joint ventures are in the areas of agribusiness (including food processing and packaging), power generation, defense-related equipment, tourism, and mining. Several agreements (some worth as much as $1.5 billion) have recently been concluded in these sectors, and negotiations continue for many more. Turkish officials emphasize the potential of the Middle East regional market. Recent legislation authorizes the establishment of free trade zones in Turkey, the first of which opened in 1986. Detailed information about the investment climate in Turkey can be obtained from the Embassy's Foreign Commercial Service office. Companies interested in learning more about investment opportunities in Turkey should also contact: The Foreign Investment Department, State Planning Organization (DPT), Necatibey Caddesi No. 110, Bakanliklar, Ankara.

The Overseas Private Investment Corporation and the Trade and Development Program (an agency of the Department of State) have active programs in Turkey. The Private Enterprise Bureau of the U.S. Agency for International Development, jointly with the Turkish Union of Chambers of Commerce and Industry, has recently established a U.S.-Turkish investment promotion office in Ankara to act as a "matchmaker" between U.S. and Turkish enterpreneurs. The Turkish-U.S. Business Council and a growing number of Turkish-American businessmen's associations (including a number of new regional branches of the U.S. Chamber of Commerce-affiliated AMCHAMS) continue to be active.

Several U.S. fast food chains, car rental agencies, and convenience-store franchisors have sold franchises in Turkey, and the success of their operations will almost certainly lead Turkish firms to seek franchises in other areas of commercial activity. A copy center/business communications franchisor recently negotiated an agreement with a Turkish firm to jointly open franchise operations in several large Turkish cities.

An important new development which represents significant new opportunities for American firms is the Turkish-Soviet natural gas agreement. Under the terms of this agreement, Turkey will import a steadily increasing volume of natural gas from the Soviet Union. Turkey will pay for this gas in hard currency, and 70 percent (and possibly more) will be used by the Soviet Union to purchase consumer and light industrial goods, and industrial plant and civil engineering project development services. More information about opportunities generated by this agreement (which is expected to

expand in quantitative and qualitative terms over the next several years) is available from the Foreign Commercial Service office at the American Embassy in Ankara.

Investment Regulations: In 1980, the Turkish Government centralized the foreign investment review and approval process in the Foreign Investment Department (FID) of the State Planning Organization. This office is the principal point of contact for most potential foreign investors (tourism and petroleum sector investments are governed by different legislation).

Basic legislation governing foreign investment in Turkey is Law 6224, issued in 1954, supplemented by the present, streamlined authorization system, and the Framework Decree on Foreign Capital (Decree No. 86/10353). Subsequent decrees have clarified and expanded the FID's scope, giving it authority, for example: 1) to issue permits for the purchase and importation of intellectual property; 2) to authorize the establishment of trading, representation, or regional offices in Turkey with greatly reduced capital requirements and tax liabilities; 3) to authorize repatriation or reinvestment of assets acquired by a foreign investor through the sale or liquidation of a Turkish company or partnership; and 4) to issue work permits for foreign nationals needed for new or increased foreign investment. The FID actively promotes foreign investment in Turkey. FID officers will gladly meet with prospective foreign investors and help identify potential Turkish joint venture partners. The FID reviews (and, to date, has never disapproved) foreign investment applications, which include, inter alia, project feasibility reports and applicant-firm financial statements. The FID is authorized to approve investments of up to $50 million. Investment proposals above this limit must be approved by the Council of Ministers. Foreign investors may also be entitled to various investment incentives provided under Turkish law for specific purposes, i.e., export promotion, regional development, or tourism projects.

Financing: Given the gap between Turkey's extensive needs and its limited internally generated resources, external financing of public and private project investment will be a crucial factor in coming years. In addition to new short-term and medium-term credits available from commercial banks, the Export-Import Bank of the United States offers a variety of credit facilities to U.S. firms exporting to Turkey. U.S. firms may also compete for contracts financed by the World Bank and such third countries as Saudi Arabia and Kuwait. Foreign commercial banks, which have been supplying Turkey with short-term credits for the last several years, are now offering medium-term facilities as well. Private sector exporters generally are favored as recipients of such credits.

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